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SUBJECT: Opposition Parties' Market-Unfriendly Stance Helps Markets Rally on Likely AKP Victory

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11. (SBU) Summary: Turkish markets have rallied buoyed by global bullishness and the increasing likelihood of an AKP victory that would increase the probability of continued market-friendly policies. Investors' doubts about the principal opposition parties are attributable to these parties electoral manifestos which contain a significant amount of statist economic "old-think" that, if implemented, would be a serious negative for the investor community. End Summary.

Investors Prefer (Modest) AKP Majority:

12. (SBU) The preferred election outcome for foreign investors and market analysts has continued to be a single-party AKP government but without AKP having a majority exceeding 367 votes. An outcome with AKP getting over 367 seats heightens the probability of a clash with the secular establishment over the election of a president and constitutional changes. With the polls suggesting an AKP majority with less than 367 seats is the most likely outcome, markets have continued to rally in recent days, with a strong assist from the bullish tone in international markets.

13. (SBU) Foreign investors (and therefore the market) believe that a single-party government -- of any party -- is more likely to continue with orthodox and pro-reform economic policies. Investors also worry that the principal opposition parties, CHP (Republic People's Party) and MHP (Nationalist Movement Party), are dominated by politicians who are far more skeptical of privatization, foreign investment, the IMF's role, the EU and orthodox economic policies than the AKP.

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Opposition's Market-Unfriendly Policy Statements
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14. (SBU) The opposition parties' economic platforms offer a window into an economic philosophy that has elements of pre-1980's Turkish statist thinking. Although both CHP and MHP have people in their parties with economic policy experience, and are likely to be obliged to be prudent if they came to power, the fact that their platforms contain so many overtly "old-think" statements is off-putting for the investor community. Both CHP and MHP adopt a more nationalist approach than AKP, emphasizing domestic production.

15. (SBU) MHP: MHP's election manifesto says that it will base its economic program on a free market model. However it will promote policies against foreign capital's dominance in the economy. Their slogan will be "yes to foreign capital, no to foreign control." MHP

will be supportive of foreign investments that are production-oriented that will create jobs. The party targets increased production and employment through support for small- and medium-sized enterprises. MHP says there will be no differentiation in taxation of foreign and local investors regarding capital gains and interest income. (Currently, income tax from capital gains and interest income is 0% for foreign investors and 10% for local investors.) Interest income will be taxed more than capital gains. The manifesto states that, "Measures will be taken to prevent short term capital outflows in case of volatile markets," hinting at the possibility of capital controls. MHP calls for the primary surplus target -- the centerpiece of the IMF programs' recent success -- should be reduced to allow social spending. MHP proposes to cut the Value-Added Tax (VAT) gradually in food, education and health. MHP supports EU membership, but with many conditions.

16. (SBU) CHP: CHP focuses on creation of employment, financial stability, supporting the real sector through stable and balanced growth as well as strong industrialization. Fiscal discipline and the fight against inflation will be CHP's main priorities. Additionally, the party plans strengthening policies on industry and agriculture, fighting against unemployment and establishing a more balanced income distribution. CHP is planning to bring back sector-based incentives, which AKP has been avoiding in line with the IMF program. The party is also planning to focus on the 10 million people living in poverty, and will develop strong social policies to tackle this problem. CHP alleges that the current program has not served all of Turkey's needs and a medium-term development strategy should be adopted targeting a growth rate above 6%, unemployment under 7% and inflation below 5%. Public infrastructure investments should be accelerated. EU convergence should be supported but Turkey should adopt a more dignified policy towards the EU, and towards the U.S. CHP claims foreign capital inflows lead to an increase in foreign debt. CHP explicitly rules out privatization of State-owned Ziraat and Halk Bank. Although the

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CHP platform does not explicitly oppose other privatizations, CHP leaders have attacked the AKP governments' numerous privatizations of state-owned companies.

17. (SBU) Neither CHP nor MHP (or AKP) reveal any specific primary surplus targets. None of them unveil their views on the future of the IMF relations, although MHP has made anti-IMF statements. All three share the view that broadening the tax base is vital to increase budget flexibility. On the other hand opposition parties' views on public sector banks, foreign capital inflows and foreign participation in banking sector are different from AKP's. All three parties at least give lip service to the independence of the Central Bank, but a prominent MHP parliamentary candidate's public advocacy of a "managed float" exchange rate regime suggests they may not really mean it. Both CHP and MHP criticize current policies claiming they would change the high interest rate policy that causes what they view as the excessive appreciation of Turkish Lira. CHP's most prominent economic policy expert, former Treasury Under Secretary Faik Oztrak, said the current global market environment

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caused excessive capital inflow into Turkey that shielded AKP from its mistakes. Oztrak claimed that Turkey's Foreign Exchange reserves -- currently \$70 billion -- are not strong enough to face a serious global turbulence.

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Favorable Polls and Global Bullishness Sustain Rally:
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18. (SBU) Buoyed by the positive tone in global markets this week, capital investors priced in an AKP government, bringing the IMKB 100 stock exchange index to almost 54,000, the benchmark government bond rate to 17.4% and USD/TRY exchange rate to a record 1.25. If the elections produce a surprising outcome a market reaction is likely due to the opposition's market-unfriendly policies or, if AKP is too successful, the risk of a clash with the secular establishment over the presidency. AKP's new economic star, former Merrill Lynch economist Mehmet Simsek, warned recently that if opposition parties implement any part of their economic policies, this might lead to an economic crisis. Simsek is undoubtedly exaggerating for electoral purposes, but the MHP and CHP statements on economic policy have reinforced investors' -- especially foreign investors' -- strong

preference for AKP.
WILSON